

2015

When a Contract Obligor Becomes an Owner of the Contract

Neil Harl

Follow this and additional works at: <http://lib.dr.iastate.edu/agdm>



Part of the [Agribusiness Commons](#)

Recommended Citation

Harl, Neil (2015) "When a Contract Obligor Becomes an Owner of the Contract," *Ag Decision Maker Newsletter*: Vol. 7: Iss. 4, Article 2.

Available at: <http://lib.dr.iastate.edu/agdm/vol7/iss4/2>

This Article is brought to you for free and open access by the Agriculture and Natural Resources at Iowa State University Digital Repository. It has been accepted for inclusion in *Ag Decision Maker Newsletter* by an authorized administrator of Iowa State University Digital Repository. For more information, please contact digirep@iastate.edu.

Counter-cyclical payments for corn and soybeans, continued from page 2

Table 5. Soybean Counter-Cyclical Payments under various Prices and Yields.

U.S. Average Price	Soybean Counter-Cyclical Payments, 2002-07 Crops
\$4.90	\$.36
5.00	.36
5.10	.26
5.20	.16
5.30	.06
5.36	0

Soybean CCPs are calculated in the same way as corn, but using the soybean loan rate of \$5.00 per bushel, the direct payment of 44 cents per bushel, and the soybean target price of \$5.80 per bushel. The maximum soybean CCP for the 2002 through 2007 crops is 36 cents per bushel.

Payment Schedule

Counter-Cyclical Payments are made available to farmers in three stages. In years when a CCP is anticipated, the first installment of the CCP is made available to producers in the fall for the next year's crop. The second payment becomes available in February and the final payment is made in early fall after the market-

Table 7. Possible CCPs for 2002 Crop Corn and Soybeans.

	Corn	Soybeans
Breakeven Price	\$2.32	\$5.36
Simple Avg Price *	2.35	5.43
Possible CCP	0	0
Est. Weighted Avg. Pr. *	2.34	5.39
Possible CCP	0	\$.00

* Approximate simple and weighted national average price (Sept.-Feb.)

ing year has ended and the marketing year average price has been determined by USDA. So, the payments for a crop may be spread over two years.

Corn and soybean CCPs under various price levels are shown in Table 4 and 5.

Monthly corn and soybean prices, along with estimates of the percentage of the crop that is marketed each month, is presented in Table 6. Estimates of the simple average and monthly average prices so far this year are shown at the bottom.

Table 6. Estimated National Average Corn and Soybean Prices (Sept. - Feb.).

Month	Estimated Corn Price	Estimated Percent Marketed	Soybean Price	Percent Marketed
September	\$2.47	8.0%	\$5.39	8.5%
October	2.34	11.0	5.19	20.9
November	2.27	12.7	5.46	9.4
December	2.32	7.0	5.46	8.1
January	2.27	12.5	5.38	15.5
February (preliminary)	2.35	6.0	5.57	6.6
Simple Avg. Price *	\$2.35	57	5.45	69
Est. Weighted Avg. Pr. *	2.34		5.39	

* Approximate simple and weighted national average price (Sept. through Feb.)

For the 2002 corn and soybean crops, USDA price projections through February 2003 indicate that marketing year average prices will be above the level that will generate CCPs as shown in Table 7. There is a chance that prices will decline enough as the season progresses so that CCPs will be made, but as of early March 2003 that appears unlikely. Periodically we will report national average prices for corn and soybeans in this newsletter.



When a Contract Obligor Becomes an Owner of the Contract *

by Neil Harl, Charles F. Curtiss Professor in Agriculture, professor of economics, 515-294-6354, harl@iastate.edu

A contract for deed or installment contract for the sale of real estate (or other assets) between parent and child is not unusual; a frequent outcome of such transactions is that the obligor under the contract becomes the owner or a

co-owner of the contract after death of the contract seller, which results in often unanticipated income tax consequences.

continued on page 4

* Reprinted with permission from the October 4, 2002 issue of Agricultural Law Digest, Agriculture Law Press publication, Eugene, Oregon. Footnotes not included

When a Contract Obligor Becomes an Owner of the Contract, continued from page 3

Effect of death of contract seller

For installment obligations held until death, the fair market value of the obligation is included in the decedent's gross estate for federal estate tax purposes. The value of the installment obligation may not be reduced by the estimated amount of income tax payable on installments remaining to be paid although courts have permitted a discount in valuing corporate stock for potential income tax liability on liquidation even though liquidation is not contemplated. A deduction is permitted to each recipient of income in respect of decedent equal to the federal estate tax attributable to the obligation.

For a beneficiary who is not the obligor, the decedent's estate is not charged with inclusion of the potential income from installment sale obligations as a result of distribution of the obligation that was entered into before the death of the decedent as seller. The income tax basis of the obligation in the hands of the beneficiary is the decedent's basis, adjusted for installments received by the estate (and the decedent) before distribution to the beneficiary. The beneficiary continues to report payments in the same manner as the decedent would have done had the decedent survived.

Disposition of contract to obligor

For deaths before October 20, 1980, different theories had been used to determine the income tax treatment of installment obligations passing to the obligor at the death of the contract seller. However, Congress in the Installment Sales Act of 1980, addressed the issue and provided that disposition of an installment obligation to the obligor after October 19, 1980, *results in recognition of any unreported gain to the deceased seller's estate*. The same treatment applies to installment obligations cancelled at death. In a 1990 private letter ruling, an installment note (the gain from which the decedent had been reporting in installments) from an heir to the decedent was cancelled; IRS ruled that the remainder of the gain on the installment sale was included in income to the decedent's estate. That is the outcome whether the disposition of

the installment obligation is by bequest, devise or inheritance by the obligor or by cancellation by the estate representative. Unless there is some act of cancellation of the obligation, the disposition is considered to have occurred no later than the conclusion of administration of the estate. For obligations held by a person other than the decedent, such as a trust, the cancellation is treated as a transfer immediately after the decedent's death by that person.

Presumably, disposition of an installment obligation to two or more persons, one of whom is the obligor, results in a taxable disposition to the extent of the obligor's interest acquired in the installment obligation. To avoid that result, the decedent could dispose of the installment obligation to the other heirs (who are not obligors under the installment obligation) with other property passing to the obligor.

Installment sale by the estate

For installment sale obligations entered into by the administrator or executor on behalf of the estate, distribution of the installment sale obligation from the estate constitutes a taxable disposition by the estate. A statutory provision shields from recognition of gain amounts with respect to property under special use valuation and then only to the extent the fair market value at death or the alternate valuation date exceeds the special use value and then only if the transfer is to a qualified heir. The exception in I.R.C. § 453B(c), for "transmission of installment obligations at death," does not apply to installment obligations entered into by the estate inasmuch as the distribution of installment obligations entered into by an estate would not involve "the transmission of installment obligations at death."

In conclusion

The disposition of installment obligations at death deserves careful planning attention before death of the seller under the obligation if deferral of recognition of gain is to be assured under income in respect of decedent rules.